



501-07.00

Department of the Treasury
Internal Revenue Service
1100 Commerce Street
Dallas, TX 75242

Release Number: **201317015**
Release Date: 4/26/2013
Date: January 14, 2013

LEGEND

ORG - Organization name

XX - Date Address - address

Form:
Tax Year(s) Ended:

Person to Contract:

Contact Telephone Number:

ORG
ADDRESS

CERTIFIED MAIL

Dear :

We have completed our examination of your Form 990 for the periods ended December 31, 20XX. It has been determined that your exempt status should be revoked.

The previous report of examination issued on August 8, 20XX, states the basis for the revocation. You have concurred with our determination by signing Form 6018-A, Consent to Proposed Adverse Action, on September 17, 20XX. A copy of which is enclosed. Accordingly, your exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code has been revoked effective January 1, 20XX.

You are required to file Federal income tax return, Form 1120, with the Internal Revenue Service Center. We have secured the delinquent Forms 1120 for the periods ended December 31, 20XX; December 31, 20XX; December 31, 20XX. When filing future returns, remember the Internal Revenue Code section 277 may limit your deductions.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If we do not hear from

ORG

you within 30 days of the date of this letter, this determination will be considered final and no further action will be required.

Please keep a copy of this report with your permanent records.

If you have any questions regarding this matter, please contact the person whose name and telephone number are shown above.

Sincerely yours,

Nanette M. Downing
Director, EO Examination

Enclosure(s):
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE: EO Examinations
1100 Commerce Street
Dallas, TX 75242

August 8, 2012

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG EIN		Year/Period Ended December 12, 20XX

LEGEND

ORG - Organization name

XX - Date

CO-1 - 1st COMPANY

EIN - EIN

August 08, 20XX

ISSUE:

Does ORG continues to qualify as an organization described in the Internal Revenue Code Section 501(c)(7), even though it receives less than % of its operating revenue from its members, and substantially all the rest of its revenue from the general public?

FACTS:

ORG, (the organization) received income tax exemption as described in IRC 501(c)(7) in 19XX, instead of the IRC 501(c)(4) it applied for because it did not meet the requirements for that Code. Even though the organization appealed, that decision, it has continue to check its form 990 returns as a 501(c)(4) organization. The books and records of the organization for the period ending December 31, 20XX were examined; and it was found that the club is not in complying with the requirements of Public Law 94-568 and Revenue. Procedure 71-17. The general public participates in its events that are carried on including sanctioned matches, dog shows etc, but the organization failed to maintain records of nonmember receipts as required by Rev. Proc. 71-17.

The organization listed the following objectives in its Constitution: "To further the advancement of all breeds of pure-bred dogs (all-breed clubs); to do all in its power to protect and advance the interests of dog shows, obedience trials and to encourage sportsmanlike competition at such events; and to conduct sanctioned matches, dog shows and obedience trials under the rules of the CO-1."

ORG is organized and operating as an organization described in Internal Revenue Code § 501(c)(7) to provide social, recreational and other activities to its members. But in carrying out its stated objectives above, the general public/nonmembers regularly participate in the Club's activities and the organization failed to keep records of its nonmember's participation and/or receipts. Available record of retained copy of returns filed by the Organization for prior years show that the organization has generated nonmember income in excess of % threshold permitted in Public Law 94-568 since at least in the last three years analyzed as shown in Exhibit A below, and failed to file the applicable form 990-T prior to our examination.

Based on the analysis of the amounts reported on the organization's retained copies of Form 990 returns and available records, the percentage of gross receipts from nonmembers are as follows:

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EXHIBIT: A

ORG - Gross Receipts Per Form 990 Returns

Tax Year	Gross income	Membership dues/income	Nonmember Income	% of non- member income	% of member- ship income
20XX1 2					
20XX1 2					
20XX1 2					

Percentage of investment income was as follows: 20XX = .05, 20XX = .03, and 20XX = .02 of the organization's gross receipts. The above Exhibit shows that the organization substantially depends on the receipts from the general public or nonmembers, while maintaining very low membership dues and assessment of \$ a year per interview of the officer and examination of the books and records. It is clear that the organization will not be able to continue in operation without the revenue from the public or nonmembers that essentially provide substantial financial benefits to the members that will otherwise have to bear these costs.

LAW

IRC Section 501(c)7 states (in specifying attributes for exemption):

"Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder."

Revenue Ruling 58-589, 1958-2 C.B. 266, provides that operational costs covered by nonmember patronage, would be an indicator of inurement, provided the club's assets are distributable to club members upon dissolution. The effect of this Ruling is that a club can overall experience a loss in any given business year, but inurement can take the form of any excess of nonmember receipts over direct costs, covering expenses that the members of the club would have to bare if it were not for the income provided by nonmember patronage.

Revenue Ruling 1960-324, 1960-2 C.B. 173, weighed the following factors in its findings that a club that makes its facilities available to the general public on a regular, recurring, basis should no longer be recognized under IRC Section 501(c)(7):

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Name of Taxpayer ORG EIN		Year/Period Ended December 12, 20XX

percentage of nonmember gross receipts (ranged from - % in this case), gross profit from the unrelated activities, net profit overall and the number of outside (unrelated) functions compared to total functions of the club. It was also indicated that internal analysis of the club showed that if these outside activities were discontinued, a substantial increase in the amount of annual dues from club members would be necessary.

Internal Revenue Code Section 501(c)(7) provides for the exemption from Federal income taxes for Social Clubs. Income Tax Regulation section 1.501(c)(7)-1 states that if a Social Club makes its social and recreational facilities available to the general public it will not qualify for tax-exempt status.

However, Revenue Procedure 71-17 as amended by Public law 94-568 provides certain gross receipts safe harbors; i.e. Social Clubs may receive up to 35% of their total gross receipts, including investment income from sources outside of their membership without jeopardizing their tax exempt status. Within this 35% limit, no more than 15% of a club's gross receipts may be derived from nonmember use of the club's facilities and/or services. Reg. 1.501(c)(7)-1(a) states, in part: In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from nonmembers through the use of club facilities or in connection with club activities. If a club exceeds the 15/35% test, then it will maintain its exempt status only if it can show through facts and circumstances that "substantially all" of its activities are for "pleasure, recreation and other nonprofitable purposes."

The following are important facts and circumstances to take into account to determine whether a club may maintain its exemption under IRC 501(c)(7):

- Frequency of use of the club facilities or services by nonmembers. An unusual or single event (that is, nonrecurring on a year to year basis) that generates all the nonmember income is viewed more favorably than nonmember income arising from frequent use or participation by nonmembers.
- Record of nonmember use over a period of years. A high percentage in one year by nonmembers, with the other years being within permitted levels, is viewed more favorably than a consistent pattern of exceeding the limits, even by relatively small amounts. (See S. Rept. 94-1318, 2d Sess., 1976-2 C.B. 597,599).
- Purposes for which the club's facilities were made available to nonmembers.

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- Whether the nonmember income generates net profits for the organization.

TAXPAYER'S POSITION:

Taxpayer has tentatively indicated agreement with the examination findings, but will have to officially do so by signing and returning the closed Form 6018.

GOVERNMENT'S POSITION:

ORG has exceeded the % gross receipts limits for nonmember income on a continuous basis for at least in the three years. The nonmember receipts are earned in the organization's regular fundraising activities. There was no one single or unusual event that caused the club to exceed the % threshold that was not taken into consideration. It is clear from this examination that the organization has not only exceeded the % percent legal limit, but also not operating exclusively for exempt purpose, and should be revoked. It shows that the organization is not substantially supported by its member receipts as required under this Code. This represents enormous inurement for the shareholders bared by the IRC 501(a).

The organization's exempt status should be revoked effective January 1, 20XX, the date the material change in exemption was first noted. Rev. Proc. 84-46, 1984-1 C.B. 541.

As a taxable entity, the organization is required to file Form 1120, U.S. Corporation Income Tax Return for the periods open under statute. Under 6501(g) these periods include the years ending December 31, 20XX through December 31, 20XX. These will replace any Form 990-T returns filed for these years.

Additionally, the organization is reminded of the provisions of IRC 277 concerning membership organizations which are not exempt organizations.

In accordance with the provisions of Internal Revenue Code Section 6014, copies of these examination conclusions and consent to the revocation of tax exemption will be submitted to the State of Florida Revenue Department at the conclusion of the examination.

Section 501(c)(7), in part, provides for the exemption from federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, exclusively all the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

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Explanation of Items		
Name of Taxpayer		Year/Period Ended
ORG	EIN	December 12, 20XX

ALTERNATIVE ISSUE:

In the alternative, if the organization qualifies for exemption under section 501(c)(7), should the actual net income from nonmembers and other non-exempt activity income not be taxable as unrelated business income under section 511 of the Code?

BRIEF EXPLANATION OF FACTS

The organization failed to file Information and Form 990-T, Exempt Organization Unrelated Business Income Tax Returns for the prior, current and subsequent years prior to this examination, the delinquent returns secured before all the examination issues were fully developed that led to the decision to propose revocation.

LAW

Section 511(a) of the Code imposes a tax upon the unrelated business taxable income of organizations exempt from federal income tax.

Section 513(a) defines the term unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds of the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions.

Section 513(c) provides that a trade or business includes any activity which is carried on for the production of income from the sale of goods. An activity does not lose its identity as trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may not be related to the exempt purposes of the organization.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related " to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than the production of income). Further, it is "substantially related," for purposes of section 513 of the Code only if the causal relationship is a substantial one. For this relationship to exist, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those exempt purposes.

TAXPAYER POSITION:

Taxpayer has tentatively indicated agreement with the examination findings, but will have to officially do so by signing and returning the closed Form 6018.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Period Ended
ORG EIN		December 12, 20XX

GOVERNMENT POSITION:

ORG has exceeded the % gross receipts limits for nonmember income on a continuous basis for at least in the three years. The nonmember receipts are earned in the organization's regular fundraising activities. There was no one single or unusual event that caused the club to exceed the % threshold that was not taken into consideration. It is clear from this examination that the organization has not only exceeded the % percent legal limit, but also not operating exclusively for exempt purpose. It shows that the organization is not substantially supported by membership receipts as required under this Code. This represents enormous inurement for the shareholders bared by the IRC 501(a). Revocation of exemption status is warranted.

CONCLUSION:

ORG no longer qualifies for exemption under § 501(c)(7) of the Internal Revenue Code as nonmember income has exceeded the % threshold permitted by Public Law 94-568. Therefore, your exempt status under § 501(c)(7) of the Internal Revenue Code should be revoked effective January 01, 20XX. Should this revocation be upheld, Form 1120 must be filed starting with tax periods ending December 31, 20XX through December 31, 20XX.

Note: If you appeal the proposed revocation, please refer to the enclosed Publication 892. Appeal should contain statement of facts declared true under penalties of perjury. Please refer to Publication 892, page 3 for example of statement signed under penalties of perjury.

Our examination of your exempt organization was primarily a compliance audit, and such audit is conducted to verify your continued compliance with IRC Section 501(c)(7). The Board of Directors has a fiduciary responsibility to ensure full compliance of the IRC Section 501(c)(7).

Thank you for your cooperation.